

COTTONWOOD IMPROVEMENT DISTRICT

FINANCIAL STATEMENTS
with
INDEPENDENT AUDITORS' REPORTS

DECEMBER 31, 2005

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Cottonwood Improvement District
Salt Lake City, Utah

We have audited the accompanying basic financial statements of Cottonwood Improvement District as of and for the year ended December 31, 2005, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Cottonwood Improvement District as of December 31, 2005, and the results of its operations and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 10, 2006 on our consideration of Cottonwood Improvement District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis is not a required part of the financial statements, but is supplementary information the Governmental Accounting Standards Board requires. We applied limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion thereon.

Pinnock, Robbins, Posey & Richins

April 10, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Cottonwood Improvement District's (the District) annual financial report presents our analysis of the District's financial performance during the year ended December 31, 2005. We encourage readers to consider the information presented here in conjunction with the financial statements and accompanying notes to enhance their understanding of the District's financial activities.

Financial Highlights:

- Interest income increased by \$245.3 thousand (or 74.9%) in 2005, attributable to an average increase of 1.52% in interest rates during the year.
- Operating expenses increased \$489.4 thousand (9.7%), due in most part to an adjustment of the wage scale, net interest that the District paid when the Central Valley Digester Project and the Central Valley Expansion Project were reconciled as to ownership costs, and also increased depreciation for new vehicles and additions to the collection system.
- Capital contributions made in the form of sewer lines from developers increased \$222.2 thousand (216.1%).
- Net assets have decreased by \$2,894.9 thousand as a result of the planned use of District's reserves.

Overview of Financial Report:

This annual report consists of two parts: Management's Discussion and Analysis and Financial Statements. The Financial Statements also include notes that explain in more detail some of the information in the financial statements.

The Management's Discussion and Analysis (MD&A) serves as an introduction to the basic financial statements and supplementary information. The MD&A represents management's analysis of the District's financial condition and performance.

The Financial Statements report information about the District using full accrual accounting methods as utilized by similar business activities in the private sector. They include a balance sheet; a statement of revenues, expenses and changes in net assets; a statement of cash flows; and notes to the financial statements. The balance sheet presents the financial position of the District on a full accrual historical cost basis. While the balance sheet provides information about the nature and amount of resources and obligations at year end, the statement of revenues, expenses and changes in net assets presents the results of business activities over the course of the year and information as to how the net assets changed during the year. The statement of cash flows presents changes in cash and cash equivalents, resulting from operating, non-capital and related financing, capital and related financing, and investing activities. In other words, it provides information regarding where the cash came from and how it was used, and the change in cash balance during the reporting period. The notes to the financial statements provide required disclosures and other information that are essential to the full understanding of material data provided in the statements. The notes present information about the District's accounting policies, significant account balances, obligations, commitments, contingencies and subsequent events, if any.

Financial Analysis:

To begin our analysis, a summary of the District's balance sheet is presented in the schedule below. This section will discuss and analyze significant differences between the years ended December 31, 2004 and 2005.

**Cottonwood Improvement District
Balance Sheet**

	2005	2004
Current and Other Assets	\$34,625,648	\$36,665,380
Capital Assets	<u>28,545,524</u>	<u>27,571,278</u>
Total Assets	<u>\$63,171,172</u>	<u>\$64,236,658</u>
Current Liabilities	\$ 1,737,711	\$ 1,296,825
Noncurrent Liabilities	<u>1,408,506</u>	<u>20,000</u>
Total Liabilities	<u>3,146,217</u>	<u>1,316,825</u>
Net Assets Invested in Capital Assets, Net of Related Debt	28,545,524	27,571,278
Net Assets Unrestricted	<u>31,479,431</u>	<u>35,348,555</u>
Total Net Assets	<u>60,024,955</u>	<u>62,919,833</u>
Total Liabilities and Net Assets	<u>\$63,171,172</u>	<u>\$64,236,658</u>

The balance sheet includes all of the District's assets and liabilities, and equity which is categorized as either invested in capital assets, net of related debt; restricted; or unrestricted. Net assets may serve as a useful indicator of a government's financial position. As can be seen from the schedule above, assets exceeded liabilities by \$60,024,955 at the end of the year. The largest portion of the District's net assets, \$28,545,524 (47.6%), reflects its investment in capital assets (e.g., land, buildings, sewer lines and equipment). The District uses these capital assets in its daily operations; consequently, they are not available for future spending.

While the balance sheet shows the change in financial position of net assets, the summary of the District's statements of revenues, expenses and changes in net assets, provides information regarding the nature and source of these changes as seen in the following schedule. Net assets decreased in 2005 by \$2,894,878 as a result of the planned use of the District's cash reserves.

**Cottonwood Improvement District
Condensed Statement of Revenues, Expenses, and Changes in Net Assets**

	2005	2004
Operating Revenues	\$ 1,197,361	\$ 1,133,450
Non-operating Revenues	<u>2,459,052</u>	<u>2,234,064</u>
Total Revenues	<u>3,656,413</u>	<u>3,367,514</u>
Depreciation Expense	1,185,443	1,097,980
Other Operating Expense	4,331,314	3,929,356
Non-operating Expense	<u>1,359,558</u>	<u>1,076,447</u>
Total Expenses	<u>6,876,315</u>	<u>6,103,783</u>
(Loss) Before Capital Contributions	(3,219,902)	(2,736,269)
Capital Contributions	<u>325,024</u>	<u>102,799</u>
Change in Net Assets	(2,894,878)	(2,633,470)
Net Assets - Beginning of Year	<u>62,919,833</u>	<u>65,553,303</u>
Net Assets - End of Year	<u>\$60,024,955</u>	<u>\$62,919,833</u>

Capital Assets and Debt Administration:

Capital assets. A review of the schedule below shows that capital assets (net of depreciation) increased \$974,246. The major capital asset events during the year included the following:

- Sewer line and manhole rehabilitations and replacements took place totaling \$1,265,182. In addition, developers contributed sewer lines to the system in the amount of \$325,024.
- An additional large flusher vehicle was added to the fleet at a cost of \$250,000.
- A water truck and tanker was replaced at a cost of \$152,283.

Cottonwood Improvement District Capital Assets, Net of Depreciation

	<u>2005</u>	<u>2004</u>
Land and Right of Ways	\$ 1,131,234	\$ 1,131,234
Buildings and Structures	2,726,988	2,947,569
Collections System	23,834,590	22,827,052
Equipment	265,308	293,509
Vehicles	585,547	369,471
Furniture and Fixtures	<u>1,857</u>	<u>2,443</u>
Total Capital Assets (Net of Depreciation)	<u>\$28,545,524</u>	<u>\$27,571,278</u>

Additional information on Cottonwood Improvement District's capital assets can be found in Note 3 on pages 16-17 of this report.

Long-term debt. At the end of the current fiscal year, Cottonwood Improvement District had total bonded debt outstanding in the amount of \$1,471,688, consisting entirely of revenue bonds. This represents Cottonwood Improvement District's portion of revenue bonds issued to Central Valley Water Reclamation Facility and distributed to the District and is the District's obligation.

Long-Term Debt

	<u>2005</u>	<u>2004</u>
Revenue bonds	\$1,471,688	\$ 0

Additional information on Cottonwood Improvement District's long-term debt can be found in Note 6 on pages 19-20 of this report.

Next Year's Rates:

The District has been successful in reducing its cash reserves. This has been accomplished by maintaining level sewer rates since 1996 and significantly reducing the property tax rate in 2001. However, it is prudent to maintain a certain level of reserves for emergencies and capital improvements to the system.

The District's sewer system continues to age. One third of the District's approximately 350 miles of sewer lines is approaching 50 years old. Another third is between 35 and 50 years. Over time, the hydrogen sulfide gas (which is produced by sewage in the lines), causes the sewer pipe to deteriorate, which requires the replacement or rehabilitation of the sewer lines.

In order to maintain the appropriate level of cash reserves and cover increased operating expenses and expensive infrastructure replacements and rehabilitation, it is necessary to increase the sewer rate. Effective January 1, 2006 the sewer rate was increased from \$3 to \$12 per month per resident or residential equivalent.

Final Comments:

This financial report is designed to provide taxpayers, customers and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions regarding this report or need additional financial information, contact the Controller of the Cottonwood Improvement District, 8620 Highland Dr., Sandy, Utah 84093 or by phone (801)943-7671.

COTTONWOOD IMPROVEMENT DISTRICT

BALANCE SHEET

DECEMBER 31, 2005

ASSETS

CURRENT ASSETS:

Cash and cash equivalents \$ 16,803,085

Receivables:

Service charges 79,577

Certified service charges 10,860

Connection fees 1,680

Property taxes 34,711

TOTAL RECEIVABLES 126,828

NOTE RECEIVABLE, CURRENT PORTION 31,526

TOTAL CURRENT ASSETS 16,961,439

RESTRICTED ASSETS:

Escrow - Solitude Improvement District 10,000

Escrow - Fire Station 10,000

TOTAL RESTRICTED ASSETS 20,000

NOTE RECEIVABLE, LONG-TERM PORTION 211,529

CAPITAL ASSETS (NET OF ACCUMULATED DEPRECIATION) 28,545,524

OTHER ASSETS:

Advance to Central Valley Water Reclamation Facility 244,612

Investment in Central Valley Water Reclamation Facility 17,188,068

TOTAL OTHER ASSETS 17,432,680

TOTAL NONCURRENT ASSETS 46,209,733

TOTAL ASSETS \$ 63,171,172

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable:	
Central Valley Water Reclamation Facility	\$ 182,374
Trade	478,795
Other	29,772
Accrued vacation and sick leave	604,050
Accrual interest payable	38,953
Deferred revenue	320,585
Revenue bonds payable – current	<u>83,182</u>

TOTAL CURRENT LIABILITIES	<u>1,737,711</u>
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LIABILITIES PAYABLE FROM RESTRICTED ASSETS:

Escrow - Fire Station	10,000
Service Escrow – Solitude	<u>10,000</u>

TOTAL LIABILITIES PAYABLE FROM RESTRICTED ASSETS	<u>20,000</u>
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REVENUE BONDS PAYABLE	<u>1,388,506</u>
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TOTAL NONCURRENT LIABILITIES	<u>1,408,506</u>
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TOTAL LIABILITIES	<u>3,146,217</u>
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NET ASSETS:

Invested in capital assets, net of related debt	28,545,524
Unrestricted	<u>31,479,431</u>

TOTAL NET ASSETS	<u>60,024,955</u>
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TOTAL LIABILITIES AND NET ASSETS	<u>\$63,171,172</u>
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COTTONWOOD IMPROVEMENT DISTRICT

**STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS**

YEAR ENDED DECEMBER 31, 2005

OPERATING REVENUES:

Charges for services	\$ 1,159,538
Other	<u>37,823</u>

TOTAL OPERATING REVENUES	<u>1,197,361</u>
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OPERATING EXPENSES:

Personal services	2,151,766
Central Valley Water Reclamation Facility Operations	1,450,160
Depreciation	1,185,443
Materials, supplies and repairs	386,749
Other	<u>342,639</u>

TOTAL OPERATING EXPENSES	<u>5,516,757</u>
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OPERATING (LOSS)	<u>(4,319,396)</u>
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NON-OPERATING REVENUES (EXPENSES):

Property taxes	1,453,153
Interest income	572,424
Connection fees	409,902
Gain on disposal of assets	23,573
Equity in net loss of Central Valley Water Reclamation Facility	(1,234,976)
Interest expense	<u>(124,582)</u>

TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>1,099,494</u>
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(LOSS) BEFORE CAPITAL CONTRIBUTIONS	<u>(3,219,902)</u>
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DEVELOPER CONTRIBUTED SEWER LINES	<u>325,024</u>
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CHANGE IN NET ASSETS	(2,894,878)
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NET ASSETS - BEGINNING OF YEAR	<u>62,919,833</u>
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NET ASSETS - END OF YEAR	<u>\$60,024,955</u>
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COTTONWOOD IMPROVEMENT DISTRICT

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2005

CASH FLOWS FROM OPERATING ACTIVITIES:

Receipts from customers and users	\$ 1,217,104
Payments to suppliers	(1,973,466)
Payments to employees	<u>(2,058,011)</u>

NET CASH (USED IN) OPERATING ACTIVITIES (2,814,373)

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:

Property taxes	<u>1,443,361</u>
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**NET CASH PROVIDED BY NON-CAPITAL
FINANCING ACTIVITIES** 1,443,361

**CASH FLOWS FROM CAPITAL AND RELATED FINANCING
ACTIVITIES:**

Receipts from connection fees	407,922
Acquisition and construction of capital assets	(1,850,773)
Proceeds from bonds issued by Central Valley Water Reclamation Facility	1,471,688
Interest paid	(85,629)
Principal payments - note receivable	213,065
Proceeds from sale of capital assets	<u>39,681</u>

**NET CASH PROVIDED BY CAPITAL AND RELATED
FINANCING ACTIVITIES** 195,954

CASH FLOWS FROM INVESTING ACTIVITIES:

Capital acquisitions in Central Valley Water Reclamation Facility	(384,054)
Capital distributions from Central Valley Water Reclamation Facility	333,587
Receipts from change in ownership in Central Valley Water Reclamation Facility	126,419
Interest received	<u>572,424</u>

NET CASH PROVIDED BY INVESTING ACTIVITIES 648,376

NET (DECREASE) IN CASH AND CASH EQUIVALENTS (526,682)

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR 17,349,767

CASH AND CASH EQUIVALENTS - END OF YEAR \$16,823,085

CASH APPEARS ON THE BALANCE SHEET AS FOLLOWS:

Cash and cash equivalents - unrestricted	\$16,803,805
Cash and cash equivalents - restricted	<u>20,000</u>

\$16,823,805

COTTONWOOD IMPROVEMENT DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2005

RECONCILIATION OF OPERATING (LOSS) TO NET CASH
(USED IN) OPERATING ACTIVITIES:

Operating (loss)	\$ (4,319,396)
Adjustments to reconcile operating (loss) to net cash (used in) operating activities:	
Depreciation	1,185,443
Changes in operating assets and liabilities:	
(Increase) decrease in:	
Receivables	829
Increase (decrease) in:	
Accounts payable	206,082
Accrued vacation and sick leave	93,755
Deferred revenue	<u>18,914</u>

NET CASH (USED IN) OPERATING ACTIVITIES	<u><u>\$ (2,814,373)</u></u>
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NON-CASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:

The District received additions to the collection system in the amount of \$325,024 in 2005, which represent the fair value of sewer trunk lines deeded to the District. These additions were accounted for as capital contributions in the statements of revenues, expenses and changes in net assets.

The District recognized its proportionate share of equity in the net loss of Central Valley Water Reclamation Facility in the amount of \$1,234,976 for the year ended December 31, 2005.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2005

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Cottonwood Improvement District (the District) was created in 1955 and operates under Title 17A-2-301-330 (Utah Code Annotated 1953). The District is governed by a Board of Trustees comprised of three publicly elected members. The District is a special purpose governmental entity engaged in business-type activities. The District constructs, operates, and maintains sewage systems for the collection, treatment, and disposition of sewage.

The accounting policies of the District conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the significant accounting policies:

a. Reporting Entity

In determining the reporting entity, the District applied the Criteria of Statement No. 14 of the Government Accounting Standards Board. The underlying concept of Statement No. 14, is that the financial reporting entity consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The criteria used for determining financial accountability is whether the District's board appoints a voting majority of the potential component units' (PCU) board, whether the board of the primary government can impose their will on the PCU and whether the PCU imposes a financial benefit or burden on the primary government. Cottonwood Improvement District applied this criteria and concludes there are no potential component units that should be included in the reporting entity.

b. Measurement Focus and Basis of Accounting

The District is an enterprise fund, which is reported using the *economic resources measurement focus* and the *accrual basis of accounting*. An enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs of providing services to the general public on a continuing basis are financed or recovered primarily through user charges. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The District applies all GASB pronouncements as well as Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

c. Investments

Investments are carried at cost, which approximates market.

d. Property, Plant, and Equipment

Property, plant, and equipment are stated at cost for assets acquired or constructed. Contributed fixed assets are recorded at estimated fair market value at the time received. Depreciation is provided using the straight-line method over estimated useful lives; 50-66 years for the sewage collection system, 20-33 years for buildings, and 4-17 years for equipment.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e. Accrued Vacation and Sick Leave

Benefits for vacation leave are accounted for on the accrual basis. Accrued vacation is accumulated and up to 320 hours may be carried over into the next year. In the event of termination, employees are reimbursed for the entire amount of accumulated vacation. Effective January 1, 2002, the District adopted a new sick leave policy. Employees receive a cash pay out of 25% of unused sick leave earned each year, and the remaining hours are carried over into the next year and may be accumulated up to 1,560 hours. In the event of termination, employees receive no benefit for accrued unused sick leave unless they are retiring. Retiring employees receive a cash pay out of 25% of accumulated sick leave, and the remaining amount will be used to pay for the retiring employees' health insurance premiums.

f. Deferred Revenue

Payments received and billings for service charges made in advance are deferred and recognized as revenue when earned.

g. Property Taxes

The budgeting and accounting for property taxes is accounted for on an accrual basis with appropriate recognition of taxes receivable at year end. The property tax revenue of the District is levied, collected, and distributed by Salt Lake County as required by State law.

Utah statutes establish the process by which taxes are levied and collected. The County Assessor is required to assess real property as of January 1 and complete the tax rolls by May 15. The property taxes attach as an enforceable lien on real property as of January 1. By the third Monday in September, the auditor is to deliver the completed assessment rolls to the County Treasurer. Tax notices are mailed with a due date of November 30. Property tax receivables are recorded as of the date levied (assessed). Personal property taxes are also recorded as receivables and revenues in the accompanying financial statements.

h. Statements of Cash Flow

For purposes of the statements of cash flows, the District considers cash equivalents to be all highly liquid investments with original maturities of three months or less.

2. DEPOSITS AND INVESTMENTS

The State of Utah Money Management Council has the responsibility to advise the State Treasurer about investment policies, promote measures and rules that will assist in strengthening the banking and credit structure of the state and review the rules adopted under the authority of the State of Utah Money Management Act that relate to the deposit and investment of public funds.

The District follows the requirements of the Utah Money Management Act (*Utah Code*, Section 51, Chapter 7) in handling its depository and investment transactions. The Act requires the depositing of District funds in a qualified depository. The Act defines a qualified depository as any financial institution whose deposits are insured by an agency of the Federal Government and which has been certified by the State Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the Utah Money Management Council.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. DEPOSITS AND INVESTMENTS (CONTINUED)

A. Deposits

	<u>Bank Balances</u>	<u>Book Balances</u>
Cash on hand	\$ —	\$ 200
Cash on deposit	<u>106,954</u>	<u>29,592</u>
 TOTAL	 <u>\$ 106,954</u>	 <u>\$ 29,792</u>

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal deposit policy for custodial credit risk. As of December 31, 2005, \$1,086 of the District's bank balances of \$106,954 was uninsured and uncollateralized.

B. Investments

The Money Management Act defines the types of securities authorized as appropriate investments for the District and the conditions for making investment transactions. Investment transactions may be conducted only through qualified depositories, certified dealers, or directly with issuers of the investment securities.

Statutes authorize the District to invest in negotiable or nonnegotiable deposits of qualified depositories and permitted negotiable depositories; repurchase and reverse repurchase agreements; commercial paper that is classified as "first tier" by two nationally recognized statistical rating organizations, one of which must be Moody's Investors Services or Standard & Poor's; bankers' acceptances; obligations of the United States Treasury, including bills, notes, and bonds; bonds, notes, and other evidence of indebtedness of political subdivisions of the State; fixed rate corporate obligations and variable rate securities rated "A" or higher, or the equivalent of "a" or higher, by two nationally recognized statistical rating organizations; shares or certificates in a money market mutual fund as defined in the Act; and the Utah State Public Treasurer's Investment Fund.

The Utah State Treasurer's Office operates the Public Treasurer's Investment Fund (PTIF). The PTIF is available for investment of funds administered by any Utah public treasurer.

The PTIF is not registered with the SEC as an investment company. The PTIF is authorized and regulated by the Money Management Act, Section 51-7, *Utah Code Annotated, 1953*, as amended. The Act established the Money Management Council, which oversees the activities of the State Treasurer and the PTIF and details the types of authorized investments. Deposits in the PTIF are not insured or otherwise guaranteed by the State of Utah, and participants share proportionally in any realized gains or losses on investments.

The PTIF operates and reports to participants on an amortized cost basis. The income, gains, and losses-net of administration fees, of the PTIF are allocated based upon the participant's average daily balance. The fair value of the PTIF investment pool is approximately equal to the value of the pool shares.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. DEPOSITS AND INVESTMENTS (CONTINUED)

As of December 31, 2005, the District had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
State of Utah Public Treasurer's Investment Fund	\$16,793,293	\$16,793,293	\$ -	\$ -	\$ -

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The District's policy for managing its exposure to fair value loss arising from increasing interest rates is to comply with the State's Money Management Act. Section 51-7-11 of the Act requires that the remaining term to maturity of investments may not exceed the period of availability of the funds to be invested. Except for funds of Institutions of Higher Education acquired by gifts, grants, or the corpus of funds functioning as endowments, the Act further limits the remaining term to maturity on all investments in commercial paper, bankers' acceptances, fixed rate negotiable deposits, and fixed rate corporate obligations to 270-365 days or less. In addition, variable rate negotiable deposits and variable rate securities may not have a remaining term to final maturity exceeding two years.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's policy for reducing its exposure to credit risk is to comply with the State's Money Management Act as previously discussed. As of December 31, 2005, the District's investments in the State of Utah Public Treasurer's Investment Fund were unrated.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The District's policy for reducing the risk of loss is to comply with the Rules of the Money Management Council. Rule 17 of the Money Management Council limits investments in a single issuer of commercial paper and corporate obligations to 5%-10% depending upon total dollar amount held in the portfolio.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District does not have a formal policy for custodial credit risk.

3. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2005 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 1,131,234	\$ -	\$ -	\$ 1,131,234
Total capital assets, not being depreciated	1,131,234	-	-	1,131,234

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

3. CAPITAL ASSETS (CONTINUED)

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets being depreciated:				
Buildings and structures	\$ 4,869,651	\$ 21,764	\$ -	\$ 4,891,415
Collection system	33,271,589	1,590,206	-	34,861,795
Equipment	1,396,950	94,401	(52,789)	1,438,562
Autos and trucks	1,308,458	469,426	(68,480)	1,709,404
Furniture	28,401	-	-	28,401
Total capital assets being depreciated	<u>40,875,049</u>	<u>2,175,797</u>	<u>(121,269)</u>	<u>42,929,577</u>
Less accumulated depreciation for:				
Buildings and structures	(1,922,082)	(242,345)	-	(2,164,427)
Collection system	(10,444,537)	(582,668)	-	(11,027,205)
Equipment	(1,103,441)	(112,767)	42,954	(1,173,254)
Autos and trucks	(938,987)	(247,077)	62,207	(1,123,857)
Furniture	(25,958)	(586)	-	(26,544)
Total accumulated depreciation	<u>(14,435,005)</u>	<u>(1,185,443)</u>	<u>105,161</u>	<u>(15,515,287)</u>
Total capital assets, being depreciated, net	<u>26,440,044</u>	<u>990,354</u>	<u>(16,108)</u>	<u>27,414,290</u>
CAPITAL ASSETS, NET	<u>\$27,571,278</u>	<u>\$ 990,354</u>	<u>\$ (16,108)</u>	<u>\$28,545,524</u>

4. CENTRAL VALLEY WATER RECLAMATION FACILITY

During 1978, pursuant to the Interlocal Cooperation Act of the State of Utah, the District entered into a joint venture with four other special districts and two other cities. The Central Valley Water Reclamation Facility (Central Valley) was organized to construct and operate a regional sewage treatment facility, for the benefit of the seven members. The seven members and their related ownership interest, as of December 31, 2005 are as follows:

	Original Facility	New Expansion	Enhancements	Digesters
Cottonwood Improvement District	19.569%	7.3215%	18.1191%	8.042%
Salt Lake City Suburban Sanitary District #1	25.622	23.6177	24.7780	20.080
Granger-Hunter Improvement District	21.124	25.4755	20.2376	25.050
Kearns Improvement District	5.978	24.0002	11.2654	28.435
Murray City	8.892	6.8421	8.0168	6.280
South Salt Lake City	6.120	2.5074	5.0980	1.378
Taylorsville-Bennion Improvement District	<u>12.695</u>	<u>10.2356</u>	<u>12.4851</u>	<u>10.735</u>
	<u>100.000%</u>	<u>100.0000%</u>	<u>100.0000%</u>	<u>100.000%</u>

During 2005, Central Valley adopted a change to the member entities' percentage of ownership in the "new expansion" and the "digesters". The District's percentage ownership in the new expansion increased from 5.6817% to 7.3215% and its percentage ownership in the digesters decreased from 10.87268% to 8.042%. As a result of the changes in ownership, the District received \$40,790, including interest.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

4. CENTRAL VALLEY WATER RECLAMATION FACILITY (CONTINUED)

The joint venture is administered by a joint administration board. Each member appoints one member to the board, and voting power is not related to ownership. Therefore, each member is equal to another for voting privileges. The joint venture is responsible for adopting a budget and financing its operations, subject to the approval by each of the seven members.

The District accounts for its investment in Central Valley using the equity method of accounting. Summarized financial information of Central Valley as of December 31, 2005 and for the year then ended is as follows (in thousands):

	<u>2005</u>
Total assets	\$ 137,866
Total net assets	104,197
Revenue	9,475
Change in net assets	(6,777)
The District's interest in:	
Equity	17,188
Net loss	(1,235)

The District has recorded in prior years its previous proportionate share (19.569%) of the government grants received by Central Valley as an addition to the District's investments in Central Valley. All expenses (except depreciation) incurred by Central Valley are billed to its members. Accordingly, the District's equity in net losses of Central Valley annually approximates its share of Central Valley's depreciation expense. Audited statements are available at Central Valley Water Reclamation Facility, 800 West Central Valley Road, Salt Lake City, UT 84119.

The District incurred the following costs from the joint venture for the years ended December 31, 2005:

	<u>2005</u>
ADMINISTRATION, OPERATIONS AND MAINTENANCE	<u>\$ 1,450,160</u>
TOTAL EQUITY INVESTMENT IN CENTRAL VALLEY WATER RECLAMATION FACILITY	<u>\$17,188,068</u>

5. NOTE RECEIVABLE

The note receivable consists of an amount due from Central Valley for a land purchase in 2002. At the time of the purchase, the District had a 14.87% interest in the land and Central Valley has an 85.13% interest. The note receivable bears interest at 6%, is payable in monthly installments over ten years. Beginning on September 1, 2002, and each year thereafter on the anniversary of the beginning date, Central Valley will acquire 1.487% of the interest of the District in the land until all of the District's interest is transferred to Central Valley at the end of the term of the note.

	<u>2005</u>
Total note receivable	\$ 243,055
Less: current portion	<u>(31,526)</u>
Note receivable, long-term portion	<u>\$ 211,529</u>

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

5. NOTE RECEIVABLE (CONTINUED)

Presented below is a summary of note receivable payment requirements to maturity by years:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 31,526	\$ 13,726	\$ 45,252
2007	33,471	11,781	45,252
2008	35,535	9,717	45,252
2009	37,727	7,525	45,252
2010	40,054	5,198	45,252
Thereafter	<u>64,742</u>	<u>3,118</u>	<u>67,860</u>
TOTAL	<u>\$ 243,055</u>	<u>\$ 51,065</u>	<u>\$ 294,120</u>

6. LONG-TERM DEBT

Revenue Bonds

The government issues bonds where the government pledges income derived from the acquired or constructed assets to pay debt service. During the year, Central Valley Water Reclamation Facility issued taxable sewer revenue bonds totaling \$35,000,000 to fund the post-1993 ownership of the treatment facility. The bond bears interest at 3.00%. Cottonwood Improvement District's share of the bonds is \$2,326,388.

A portion of the revenue bonds issued during 2005 was distributed to the members. Although the revenue bonds are in the name of Central Valley Water Reclamation Facility, the members are responsible to fund debt service requirements over the life of the bonds. The amount distributed to members was \$23,000,000. The remaining bond funds drawn down as of December 31, 2005 (\$7,500,000) are being used to fund a Central Valley project and will become the members' obligations upon completion of the project. Cottonwood Improvement District's share of the \$23,000,000 bond distributed is \$1,471,688.

Revenue bond debt service requirements to maturity are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
2006	\$ 83,182	\$ 56,908	\$ 140,090
2007	85,742	56,052	141,794
2008	86,382	53,480	139,862
2009	87,661	50,888	138,549
2010	92,780	48,259	141,039
2011-2015	505,493	197,795	703,288
2016-2025	<u>530,448</u>	<u>146,427</u>	<u>676,875</u>
TOTAL	<u>\$ 1,471,688</u>	<u>\$ 609,809</u>	<u>\$ 2,081,497</u>

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

6. LONG-TERM DEBT (CONTINUED)

Long-term debt activity for the year ended December 31, 2005, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Revenue Bonds	\$ —	\$ 1,471,688	\$ —	\$ 1,471,688	\$ 83,182
TOTAL BONDS PAYABLE	\$ —	\$ 1,471,688	\$ —	\$ 1,471,688	\$ 83,182

Total interest expense incurred on long-term debt for the year ended December 31, 2005 was \$124,582, of which none was capitalized.

7. DESIGNATED NET ASSETS

The Board of Trustees of the District has designated unrestricted net assets as of December 31, 2005 for the future capital projects as follows:

	<u>2005</u>
Central Valley Water Reclamation Facility investment and expansion	\$22,528,068
Capital Construction Projects	<u>8,951,363</u>
TOTAL	<u>\$31,479,431</u>

8. EMPLOYEE RETIREMENT PLANS

Plan Description

The Cottonwood Improvement District contributes to the Local Governmental Noncontributory Retirement System, which is administered by the Utah Retirement Systems (Systems), a cost-sharing multiple-employer defined benefit pension plan. Utah Retirement Systems provide refunds, retirement benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries in accordance with retirement statutes.

The Systems are established and governed by the respective sections of Chapter 49 of the Utah code Annotated 1953 as amended. The Utah State Retirement Office Act in Chapter 49 provides for the administration of the Utah Retirement Systems and Plans under the direction of the Utah State Retirement Board (Board) whose members are appointed by the Governor. The Systems issue a publicly available financial report that includes financial statements and required supplementary information. A copy of the report may be obtained by writing to the Utah Retirement systems, 540 East 200 South, Salt Lake City, UT 84102 or by calling (800) 365-8772.

Funding Policy

In the Local Governmental Noncontributory Retirement System, the Cottonwood Improvement District was required to contribute 11.09% of their annual covered salary for 2005. The contribution rates are the actuarially determined rates. The contribution requirements of the Systems are authorized by statute and specified by the Board.

COTTONWOOD IMPROVEMENT DISTRICT

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

8. EMPLOYEE RETIREMENT PLANS (CONTINUED)

The Cottonwood Improvement District contributions to the Local Governmental Noncontributory Retirements system for December 31, 2005, 2004, and 2003 were \$156,713, \$129,042, and \$108,699, respectively. The contributions were equal to the required contributions for each year.

The District's full time employees also participate in the 401(k) plan administered by the System. The 2005, 2004, and 2003 employee contributions to the 401(k) plan were \$48,747, \$37,720, and \$37,858 respectively. The District made no contribution to the plan during 2005, 2004, and 2003.

9. PROPERTY TAX REVENUE

The District's total tax rate is .000279. The entire amount is used to meet operating and maintenance expenses. Property tax revenue for the year ended December 31, 2005 was \$1,453,153, and includes \$129,480 for motor vehicle fee-in-lieu of taxes.



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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To The Board of Directors
Cottonwood Improvement District

We have audited the financial statements of Cottonwood Improvement District, as of and for the year ended December 31, 2005, and have issued our report thereon dated April 10, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Cottonwood Improvement District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Cottonwood Improvement District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

This report is intended for the information of the Cottonwood Improvement District's management, Board of Directors, and applicable federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Pinnock, Robbins, Posey & Richins

April 10, 2006



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INDEPENDENT AUDITORS' REPORT ON STATE LEGAL COMPLIANCE

To the Board of Directors
Cottonwood Improvement District

We have audited the financial statements of Cottonwood Improvement District, for the year ended December 31, 2005 and have issued our report thereon dated April 10, 2006. Our audit included test work on the District's compliance with those general compliance requirements identified in the State of Utah Legal Compliance Audit Guide, including:

Cash Management
Purchasing Requirements
Budgetary Compliance
Truth in Taxation

Other Compliance Requirements
Special Districts
Impact Fees

The District did not receive any major or nonmajor State grants during the year ended December 31, 2005.

The management of Cottonwood Improvement District is responsible for the District's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed no instances of noncompliance with the requirements referred to above.

In our opinion, Cottonwood Improvement District, complied, in all material respects, with the general compliance requirements identified above for the year ended December 31, 2005.

This report is intended for the use of Cottonwood Improvement District's Management, Board of Directors, and applicable federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Pinnock, Robbins, Posey & Richins

April 10, 2006



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April 10, 2006

To the Board of Directors
Cottonwood Improvement District

Dear Members:

We have completed our audit of Cottonwood Improvement District for the year ended December 31, 2005. Cottonwood Improvement District is ultimately responsible for the financial condition of the District, and for the District's compliance with finance related state and federal law. The Uniform Fiscal Procedures Act outlines responsibilities of the governing body.

The purpose of the financial statements is to report in summary form, the financial condition of the District, and the results of its operations and changes in financial condition, and to provide information to the governing body to help them satisfy their legal and political responsibilities for determining and demonstrating compliance with the various finance related state and federal law.

During our audit, we noted no matters involving the internal control structure and other operational matters that should be presented to the Board.

We sincerely appreciate the cooperation we received from the management and employees of the District during the course of the audit. It has been a pleasure working with them. We appreciate the opportunity to serve as your auditors.

Pinnock, Robbins, Posey & Richins

Pinnock, Robbins, Posey & Richins, PC